Agenda Item

Report to:	**Audit, Best Value & Community Services Scrutiny Committee**
Date:	**28 February 2012**
By:	**Chief Executive and Director of Corporate Resources**
Title of report:	**External Audit Plan 2011/12**
Purpose of report:	**To inform the Committee of the content of the external audit plan for 2011/12**

RECOMMENDATION: The Committee is recommended to consider and comment upon the External Audit Plan for 2011/12.

1. Financial Appraisal

1.1 The Plan confirms the core external audit fee as £187,465 an increase of 1.6% on 2010/11. This fee includes an additional charge of £1,750 to take account of the audit work that is required to be carried out at billing authorities in East Sussex to provide assurance over the Council's share of accrued council tax income, council tax debtor and creditor balances and associated impairment allowances. In addition to these core fees, there are also charges for grant claim certification of c£17,000, charges for dealing with any complaints or objections to the 2011/12 accounts and the Audit Commission's fee for the National Fraud Initiative.

2. Supporting Information

2.1 The Plan sets out in more detail the work the external auditors will conduct in order to audit the Council's 2011/12 accounts. The Plan now reflects any relevant issues that have arisen as a result of the audit of the 2010/11 accounts and other work carried out by PKF. The main risks identified by PKF are:

- Inherent risk of management over-ride of controls
- Risk of fraud affecting the recognition of revenue
- The treatment of grant income and grant receipts received in advance
- The implementation of a new fixed asset database system
- Accounting issues flowing from the ongoing development of the Waste PFI contract
- The ongoing requirement to deliver savings to meet reductions in local government funding.

2.3 Officers will continue to liaise with PKF to ensure that their work is delivered as efficiently and effectively as possible and that internal and external audit plans are complementary and make best use of audit resources. The Plan will be reported to Cabinet for approval on 6 March.

BECKY SHAW Chief Executive	SEAN NOLAN Director of Corporate Resources
Contact Officers	Duncan Savage, 01273 482330 Jane Mackney, 01273 482146

Local Member: All

<u>Background Documents</u>
None

PKF

Accountants & business advisers

East Sussex County Council

Audit Plan 2011/12

February 2012

Local Public Services

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1 Executive summary

1.1 We are pleased to present our Audit Plan for the year ended 31 March 2012. This plan summarises the work that we propose to undertake in respect of our audit of East Sussex County Council for the 2011/12 financial year. It also updates our audit fee letter that was presented to the Audit, Best Value and Community Services Scrutiny Committee in June 2011.

Scope of the audit

1.2 The scope of the audit is determined by the Audit Commission's *Code of Audit Practice for Local Government (2010)* (the '*Code*'), which covers two areas: provide an opinion on the financial statements, and to review the arrangements for securing economy, efficiency and effectiveness in the use of resources (value for money conclusion).

1.3 We are also required to audit the Whole of Government Accounts return and to undertake work on specified grant claims and returns.

Significant risks

1.4 Our audit is designed to respond to significant risks where we intend to focus additional resources in providing our opinion on the financial statements and our value for money conclusion.

Financial statements

- management override inherent risk
- revenue recognition inherent risk
- recognition of grants income and grants receipts in advance
- implementation of a new fixed assets register
- accounting for the new household waste recycling facility

Use of resources

- we will review how the Council has responded to reductions in government funding and arrangements for prioritising resources, achieving cost reductions and improving efficiency and productivity; this is not considered to be a significant risk in the short term as financial performance to date suggests that the Council will be successful in delivering its savings target for the year.

Fees

1.5 The fee for the audit of the Council for the year is £187,465, which has increased by £1,750 from the indicative fee proposed in our audit fee letter presented to the Audit, Best Value and Community Services Scrutiny Committee in June 2011. The fee has increased to take account of the audit work that is required to be carried out at billing authorities in East Sussex to provide assurance over the Council's share of accrued council tax income, council tax debtor and creditor balances and associated impairment allowances.

1.6 Based on Audit Commission 2011/12 planned audit fee data, this remains the fourth lowest fee for county councils and well below the average fee of £242,000.

1.7 We estimate the fee payable for the audit of the Council's grant claims and other Government returns, and reporting the findings of this work to the Audit, Best Value and Community Services Scrutiny Committee, to be £17,000. This fee is payable in addition to the audit fee highlighted above.

Key outputs

1.8 The key reports, opinions and conclusions from the audit will be:

- report on any significant deficiencies in internal controls in June 2012, based on the results of our interim audit visit
- detailed report on the findings from the audit to the Audit, Best Value and Community Services Scrutiny Committee and the Governance Committee in September 2012
- opinion on the financial statements by 30 September 2012
- value for money conclusion by 30 September 2012
- opinion on the Whole of Government Accounts return by 30 September 2012
- summary of findings from the audit in the Annual Audit Letter in November 2012
- report on the results of our grants certification work to the Audit, Best Value and Community Services Scrutiny Committee in February 2013.

2 Scope of the audit

Code audit

2.1 The scope of the audit is determined by the Audit Commission's *Code of Audit Practice for Local Government (2010)* (the '*Code*'), which covers two areas: provide an opinion on the financial statements, and to review the arrangements for securing economy, efficiency and effectiveness in the use of resources.

2.2 The financial statements audit requires that we obtain assurance:

- that the accounts comply with statutory requirements
- that proper practices have been observed in compiling the accounts
- that they give a true and fair view of the financial position and the expenditure and income for the year
- the information given in the Statement of Accounts is consistent with the financial statements
- that the Annual Governance Statement is not inconsistent with our knowledge.

2.3 The use of resources audit requires we review and satisfy ourselves that:

- the organisation has robust systems and processes to effectively manage financial risks and opportunities, and to secure a stable financial position that enables it to continue to operate for the foreseeable future (financial resilience)
- the organisation is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity (challenging economy, efficiency and effectiveness).

Whole of Government Accounts

2.4 Local authorities are required to prepare information to allow HM Treasury to prepare consolidated Whole of Government Accounts (WGA) based on the statutory financial statements.

2.5 The WGA return is audited in accordance with Audit Commission specified procedures and requires additional assurance to confirm that counter-party data is properly and accurately recorded. We provide an assurance report to the National Audit Office to confirm that the WGA return is consistent with the audited financial statements and that it is properly prepared.

Certification of grant claims and returns

2.6 Grant-paying bodies may require certification of an authority's claim for grant or subsidy, or of a return of financial information. The Commission provides general guidance on the certification of claims and returns to auditors and also published guidance on good practice in Claims and returns. It also provides certification instructions which auditors must follow depending on the amounts involved and the auditor's assessment of the control environment for the preparation of the claim or return.

2.7 Certification work using certification instructions is not an audit but a different form of assurance engagement designed to provide reasonable assurance, for example, that claims and returns are fairly stated and in accordance with specified terms and conditions.

2.8 For all specified grant claims and returns, we will undertake a review in accordance with the certification instruction and express a conclusion whether the claim or return: is in accordance with the underlying records (claims and returns above the minimum level and below the threshold); or is fairly stated and in accordance with the relevant terms and conditions (claims and returns over the threshold).

Purpose of the audit plan

2.9 The purpose of this audit plan is to:

- ensure that there is mutual understanding of the respective responsibilities relating to the audit
- provide you with an overview of the planned scope of the audit for the year ended 31 March 2012
- ensure that the areas of potential risk of material misstatement which we have identified are consistent with the areas which you perceive to be the key areas and to promote effective two-way communication between us.

2.10 We will also provide reports to management and members on the findings of the audit which will focus on the key issues for the Council regarding internal control, financial governance, accounting arrangements and operational performance. We aim to provide management with clear recommendations to assist with governance and service improvements that will add value to the audit.

Co-operation with other bodies

2.11 The *Code* requires co-operation between auditors and other regulatory bodies including the National Audit Office to facilitate an efficient audit. In preparing this plan, we have assumed that the Council has provided us permission to discuss issues relevant to the audit with regulators and other auditors.

3 Risk assessment

3.1 We are committed to targeting work to where it will have the greatest effect, based upon assessments of risk and performance. This means planning our audit work to address areas of risk relevant to our audit responsibilities and reflecting this in the audit fees. For each of the significant risks identified, we consider the arrangements put in place to mitigate the risk and plan our work accordingly. Current and emerging risks that do not impact on our audit are also discussed with management so that we may add value to the risk assessment process and highlight any areas of concern to the Council.

3.2 The determination of significant risks is a matter for auditors' professional judgment. Auditing standards require that in exercising this judgment, auditors exclude the effect of identified controls related to the risk to determine whether the nature of the risk, the likely magnitude of the potential misstatement and the likelihood of the risk occurring are such that they require special audit consideration.

3.3 If you consider there to be other significant risks of material misstatement in the financial statements, whether due to fraud or error, or significant deficiencies in arrangements for securing economy, efficiency and effectiveness in the use of resources, please let us know.

Financial statements audit risks

3.4 Summarised below are the significant financial statement risks that impact on our audit of which we are currently aware. More detail on our proposed approach to addressing these risks can be found in Appendix A.

Management override inherent risk

3.5 Auditing standards presume that a risk of management override of controls is present in all entities and require us to respond to this risk by testing the appropriateness of accounting journals and other adjustments to the financial statements, reviewing accounting estimates for possible bias and obtaining an understanding of the business rationale of significant transactions that appear to be unusual.

3.6 We will carry out audit procedures to review significant journals and other adjustments in preparing the financial statements, review the reasonableness of assumptions used by management when including accounting estimates, and obtain an understanding of unusual transactions.

Revenue recognition

3.7 Auditing standards presume that there are risks of fraud in revenue recognition. These risks may arise from the use of inappropriate accounting policies, failure to apply the Council's stated accounting policies or from an inappropriate use of estimates in calculating revenue. As a consequence our audit work will be designed to focus on these areas.

Grant income and grant receipts in advance

3.8 The 2010/11 *Code of practice on local authority accounting* changed the accounting treatment for government grants and contributions following amendments to the HM Treasury *Financial Reporting Manual*. Grants and contributions for revenue and capital purposes are now required to be recognised as income where there are no outstanding conditions attached to the funding, or held in liabilities where there are unmet conditions.

3.9 At 31 March 2011 the Council had £7.1 million of revenue grant receipts in advance and £32.1 million of capital receipts in advance.

3.10 Our audit of the 2010/11 financial statements found that where conditions were not explicitly stated in grant agreements, management had in some instances judged that there were implicit grant conditions. In these cases it was considered that grants have conditions attached where the Council intends to spend the grant but failure to spend the grant is likely to result in renegotiation of the contract or project, which could lead to potential repayment of unspent monies. The Council's judgements in applying the new accounting policy for recognition of Government grants and contributions were clearly documented in the financial statements. Management made written representations to us regarding these judgements and we were satisfied that these assumptions were not unreasonable.

3.11 Our discussions with management in planning for the current year's audit have indicated that the Council is re-considering its interpretation of when grants have conditions attached to them. The *Code of practice on local authority accounting / guidance notes for practitioners* includes extended guidance in this area this year. Any change in the accounting policy relating to the recognition criteria in the 2011/12 financial statements would require a restatement of relevant transactions from 1 April 2010.

3.12 Due to the subjectivity in the assessment as to whether government grants and contributions have unmet conditions, and the impact on the accounting treatment of any changes in the Council's accounting policy in this area, there is a significant risk that government grants and contributions are not correctly accounted for in revenue and receipts in advance. This is a technical accounting issue that does not impact of the actual level of grant receipts.

New fixed assets register

3.13 During the year the Council purchased a new fixed asset database and asset management system, Real Asset Management (RAM). The implementation of a new fixed assets register presents a significant audit risk in respect of the accuracy and completeness of data transferred from the old system to the new system. There is also a risk that the new system will not correctly calculate capital charges and support materially correct balances for property, plant and equipment, intangible assets, investment properties and assets held for sale in the financial statements.

3.14 We understand that the Council intends to run the old and new registers in parallel for the preparation of the 2011/12 financial statements, which will serve as a useful control to verify that the data has been correctly transferred and to ensure that the new system is correctly calculating capital charges. If this control operates effectively, there will be a reduced risk of incorrect accounting as a result of implementation of the new fixed asset register system.

Waste management contract PFI scheme

3.15 The new household waste recycling site in Newhaven, which is being financed as part of the waste management contract Private Finance Initiative (PFI) scheme, was opened on 14 July 2011 for the benefit of local residents.

3.16 Up to the date of the completion and hand over of the facility, the construction costs of the facility were 'off balance sheet' and an element of the annual contract charge has been recognised as a payment in advance. However, as the asset is now in use, it will need to be formally valued and recognised in the Council's balance sheet, with a liability for the financing provided by the PFI operator, in accordance with IFRIC 12 *Service concession arrangements* and the *Code of Practice for local authority accounting*.

3.17 The PFI model that the Council is using for the waste management contract, which was developed jointly with Brighton and Hove City Council, its partner in the contract, will need to be updated accordingly. Given the complexities involved in PFI accounting, there is a risk that the Council may not appropriately value and account for the new household waste recycling facility in accordance with the requirements of the financial reporting framework.

3.18 We understand that the waste contract team is also considering amending the PFI model that has been used to account for the waste management contract since inception. We reviewed the integrity of the model during our audit of the 2009/10 financial statements, when the Council was first required to account for its PFI schemes under International Financial Reporting Standards. There is a risk that the availability of a new model, if relevant, may result in materially different transaction outputs compared to the current model, in which case we would require detailed explanations for the differences and we would need to audit the new model.

Use of resources audit risks

3.19 We have updated our value for money risk assessment for 2011/12 to take into account matters arising from the completion of the 2010/11 audit and additional audit knowledge gained since our initial risk assessment which was included in our fee letter. We have also considered the impact of other regulators' work throughout the year as part of our evaluation of the arrangements to secure economy, efficiency and effectiveness in the use of resources.

3.20 We are required to assess how the Council has responded to reductions in government funding and arrangements for prioritising resources, achieving cost reductions and improving efficiency and productivity. There are significant financial pressures as a result of reductions in central government funding, particularly in respect of grants available to Children's Services, and the current economic climate. The Council's budget for 2011/12 includes a savings requirement of £37 million for the year, which represents 4.5 per cent of gross budgeted expenditure, and further savings of £63 million are required over the three years from 2012/13 to 2013/14

3.21 Whilst financial performance to date suggests that the Council will be successful in delivering these savings, there have been overspends in demand-led services such as Children's Services, particularly in the number of looked after children and special assessments. These are currently being offset by managed underspends in other areas, however the financial position remains challenging.

3.22 We have not identified any significant risks at this stage but we will continue to monitor the Council's delivery of its financial and strategic plans, and its arrangements to continue to challenge economy, efficiency and effectiveness.

3.23 We will also undertake a high level review of the Council's arrangements for reducing back office costs and compare this with the Audit Commission's *Back office services* and *Shared services* study guides.

4 Fees

Code audit

4.1 The fee for the audit of the Council for the year is £187,465 plus VAT. This is based on our current assessment of the risks and the work required under the Code. The fee is £1,750 higher than the indicative fee proposed in our audit fee letter presented to the Audit, Best Value and Community Services Scrutiny Committee in June 2011. This increase takes account of the audit work that is required to be carried out in respect of information provided by billing authorities in East Sussex to provide assurance over the Council's share of accrued council tax income, council tax debtor and creditor balances and associated impairment allowances. Based on Audit Commission 2011/12 planned audit fee data, this remains the fourth lowest fee for county councils and well below the average fee of £242,000.

Questions and objections

4.2 Should any arise, time spent dealing with questions and objections will be billed separately. Where possible we will provide an estimate of the likely time required to respond to the matters before starting the work.

Grants certification

4.3 Fees billed are based on the Audit Commission's grade related rates as set out in the *Work Programme and Fee Scales* on the basis of hours incurred.

4.4 We estimate the fee payable for the audit of the Council's grant claims and other Government returns, and reporting the findings of this work to the Audit, Best Value and Community Services Scrutiny Committee, to be £17,000. This is in line with the estimate provided in our fee letter in June 2011.

Fee summary

Audit area	Actual Fee 2010/11 £	Audit fee letter 2011/12 £	Revised fee 2011/12 £
Code audit			
Financial statements	145,375	145,375	147,125
Use of resources	60,975	40,340	40,340
Audit Commission scale fee	*206,350*	*185,715*	*187,465*
Additional fee for audit of 2010/11 statements	20,000	-	-
Total Code Audit fee	*226,350*	*185,715*	*187,465*
Audit Commission Rebate for International Financial Reporting Standards	(13,783)	-	-

Audit area	Actual Fee 2010/11 £	Audit fee letter 2011/12 £	Revised fee 2011/12 £
Code fee net of reduction	**212,567**	**185,715**	**187,465**
Mandated work			
Certification of claims and returns, including grants report	**17,244**	**17,000**	**17,000**

Assumptions

4.5 The fees detailed above are based on the following assumptions:

- Internal Audit will have completed its systems testing in accordance with the plans and agreed timetable, to an adequate standard, and we are able to place full reliance on this work
- there are no significant changes to your main financial systems, procedures or internal controls
- you will provide the information requested in our records required listing in accordance with the agreed deadline and that there will be no significant departures from the timetable
- you will ensure that audit reports are responded to promptly and the implementation of recommendations by the due date is actively monitored
- there are no major changes to Audit Commission or National Audit Office instructions or guidance.

4.6 The fee assumes efficient co-operation as set out above and is set at the minimum level to carry out the audit. We reserve the right to increase fees should the above assumptions not be met or where we encounter unexpected problems, or issues arise, causing significant additional work. Time spent dealing with problems or issues arising is usually that of senior people and hence the cost will necessarily often be disproportionate to the original fee.

4.7 If we need to make significant amendments to the audit fee during the course of the audit, we will first discuss this with the Director of Corporate Resources and then prepare a report outlining the reasons why the fee needs to change for discussion with the Audit, Best Value and Community Services Scrutiny Committee.

Billing arrangements

4.8 Your Code audit fee is being billed in 4 instalments of £46,428.75 from June 2011. The additional fee of £1,750 will be added to the March 2012 quarterly bill. Fees for grants certification and time spent in dealing with any questions and objections from local electors will be billed when the work is complete.

5 Key outputs

5.1 The key reports, opinions and conclusions from the audit will be:

Output	Dates
Financial statements	
Review of internal controls	April 2012
Final audit visit	July – August 2012
Audit opinion covering: • 'true and fair' opinion on the financial statements • information in the Statement of Accounts being consistent with auditor's knowledge • Annual Governance Statement prepared in accordance with guidance and not inconsistent with auditor's knowledge	Clearance meeting to be held on 17 August 2012 Audit, Best Value and Community Services Scrutiny Committee meeting 4 September 2012 Governance Committee meeting 11 September 2012 Certification deadline 30 September 2012
Opinion on the Whole of Government Accounts return	Submission by 30 September 2012
Use of resources	
Review of economy, efficiency and effectiveness Value for money conclusion	November 2011 – April 2012 Certification deadline 30 September 2012
Grants	
Audit of grant claims and returns	August – December 2012
Reporting	
Report on any significant deficiencies in internal controls	June 2012
Annual Governance Report to the Audit, Best Value and Community Services Scrutiny Committee and the Governance Committee	September 2012
Annual Audit Letter	November 2012
Grants report	February 2013

5.2 We will agree specific dates for our visits with officers in advance of each part of our programme, and we will work closely with officers during the year to ensure that all key deadlines are met. We will also meet regularly with senior officers to discuss progress on the audit and obtain an update on relevant issues.

Staffing

5.3 The following staff will be involved in the audit throughout the course of the year:

- Leigh Lloyd-Thomas – Engagement Partner
- Janine Combrinck – Director
- Katherine Needham – Audit Senior.

Communication

5.4 Auditing Standards require auditors to communicate relevant matters relating to the audit to "those charged with governance". Relevant matters include issues on auditor independence, audit planning information and findings from the audit.

5.5 We will communicate matters of governance interest that have come to our attention as a result of the performance of the audit. The audit is not designed to identify all matters that may be relevant to you. Communication may take the form of discussions or, where appropriate, be in writing.

5.6 Our contact for communications will be the Director of Corporate Resources and the Audit, Best Value and Community Services Scrutiny Committee. When communicating with the Audit, Best Value and Community Services Scrutiny Committee we will consider all individuals representing those charged with governance as informed and our responsibilities for communicating relevant matters will be discharged.

Matters that are communicated

5.7 We will communicate the following matters to you, where applicable:

- significant deficiencies in internal control identified during the audit
- significant qualitative aspects of the entity's accounting practices including the application of the applicable financial reporting framework
- significant matters discussed, or subject to correspondence with management or other employees
- uncorrected misstatements
- material misstatements that have been corrected by management
- other significant matters relevant to the financial reporting process
- material uncertainties relating to going concern
- written representations that we are requesting from you or from other parties
- expected modifications to the opinion or emphasis of matter (or other matter) paragraphs in the auditor's report
- significant difficulties that we have encountered during the course of the audit.

5.8 If we identify significant deficiencies in internal controls, we will communicate such deficiencies to you, in writing, as soon as is practicable.

Materiality and triviality

5.9 Materiality is the expression of the relative significance or importance of a particular matter in the context of the financial statements as a whole. In carrying out our work we will apply an appropriate level of materiality and as such the audit cannot be relied upon to identify all potential or actual misstatements.

5.10 For reporting purposes, we consider misstatements of less than £270,000 to be trivial, unless the misstatement is indicative of fraud.

Uncorrected misstatements

5.11 We will report to you all uncorrected misstatements that relate to the current financial year (including those arising in previous periods that have an effect on the current year financial statements) and the effect that they have individually, or in aggregate, on the opinion in the auditor's report except for those that are clearly trivial. We will identify material uncorrected misstatements individually. We will request that any uncorrected misstatements be corrected.

Independence and objectivity

5.12 Auditors appointed by the Audit Commission are subject to the *Code of Audit Practice* and *Standing Guidance for Auditors* which include the requirement to comply with International Standards on Auditing (ISA). ISA (UK and Ireland) 260 requires auditors to communicate to those charged with governance, at least annually, all relationships that may bear on the firm's independence and the objectivity of the audit engagement partner and audit staff.

5.13 In relation to the audit of the financial statements for East Sussex County Council for the financial year ending 31 March 2012, we are able to confirm that the Audit Commission's requirements in relation to independence and objectivity have been complied with.

5.14 Under the requirements of ISA (UK & Ireland) 260 – Communication with those charged with governance, we are not aware of any relationships that may bear on the independence and objectivity of the audit engagement partner and audit staff which are required to be disclosed.

Quality of service

5.15 We aim to provide a high quality of service to you at all times. If, for any reason or at any time, you would like to discuss how we might improve the service, or if you are in any way dissatisfied, please contact Leigh Lloyd-Thomas in the first instance. Alternatively you may wish to contact our Managing Partner, Martin Goodchild. Any complaint will be investigated carefully and promptly.

5.16 If you are not satisfied you may take up the matter with the Institute of Chartered Accountants in England and Wales ("ICAEW").

5.17 In addition, the Audit Commission's complaints handling procedure is detailed in their leaflet "How to complain: What to do if you want to complain about the Audit Commission or its appointed auditors", which is available on their website http://www.audit – commission.gov.uk/complaints/.

Appendix A – Risk assessment matrix

Financial statements significant risks

	Audit risk identified from planning	Accounts area and assertions	Audit response
1	**Management override** Auditing standards presume that a risk of management override of controls is present in all entities and require us to respond to this risk by testing the appropriateness of accounting journals and other adjustments to the financial statements, reviewing accounting estimates for possible bias and obtaining an understanding of the business rationale of significant transactions that appear to be unusual.	Financial statement level risk across all account headings and assertions	We will carry out audit procedures to review significant journals and other adjustments in preparing the financial statements, review the reasonableness of assumptions used by management when including accounting estimates, and obtain an understanding of unusual transactions.
2	**Revenue recognition** Auditing standards presume that there are risks of fraud in revenue recognition. These risks may arise from the use of inappropriate accounting policies, failure to apply the Council's stated accounting policies or from an inappropriate use of estimates in calculating revenue.	Occurrence, accuracy and cut-off of income	We will substantively test a sample of key income streams and debtor accruals to ensure that accounting policies have been correctly applied in determining the point of recognition of income and that estimates in debtor accruals are reasonable.

	Audit risk identified from planning	Accounts area and assertions	Audit response
3	**Recognition of grant income and grant receipts in advance** The 2010/11 Code changed the accounting treatment for government grants and contributions following amendments to the HM *Treasury Financial Reporting Manual*. Grants and contributions for revenue and capital purposes are now required to be recognised as income where there are no outstanding conditions attached to the funding, or held in liabilities where there are unmet conditions. Our audit of the 2010/11 financial statements found that where conditions were not explicitly stated in grant agreements, management had in some instances judged that there were implicit grant conditions. Our discussions with management in planning for the current year's audit have indicated that the Council is re-considering its interpretation of when grants have conditions attached to them. A change in accounting policy relating to the recognition criteria in the 2011/12 financial statements would require a restatement of relevant transactions from 1 April 2010. Due to the subjectivity in the assessment as to whether government grants and contributions have unmet conditions, and the impact on the accounting treatment of any changes in the Council's accounting policy in this area, there is a significant risk that government grants and contributions are not correctly accounted for in revenue and receipts in advance. This is a technical accounting issue that does not impact of the actual level of grant receipts.	Classification of grant income and grants/contributions receipts in advance	We will substantively test a sample of revenue and capital grants and contributions receipts in the current year and prior year to correspondence from the grant/contribution paying body and assess whether the Council has appropriately determined whether or not there are unmet conditions attached to the funding. We will review the appropriateness of any prior year adjustments made by the Council in respect of government grants and contributions, including an assessment of any unmet conditions attached to the funding.
4	**New fixed assets register** The Council has purchased a new fixed asset database and asset management system, Real Asset Management (RAM). The implementation of a new fixed assets register presents a significant audit risk in respect of the accuracy and completeness of data transferred from the old system to the new system. There is also a risk that the new system will not correctly calculate capital charges and support materially correct balances for property, plant and equipment, intangible assets, investment properties and assets held for sale in the financial statements. We understand that the Council intends to run the old and new registers in parallel for the preparation of the 2011/12 financial statements, which will serve as a useful control to verify that the data has been correctly transferred and to ensure that the new system is correctly calculating capital charges.	Valuation and completeness of property, plant and equipment, intangible assets, investment properties and assets held for sale	We will review the Council's reconciliations of the new fixed assets system to the old register, including calculations of capital charges, to ensure data has been accurately and completed transferred across and that the new system results in materially correct balances and capital charges/credits in the financial statements.

	Audit risk identified from planning	Accounts area and assertions	Audit response
5	**Waste management contract PFI scheme** **(1) Household waste recycling facility** The new household waste recycling facility in Newhaven, which is being financed as part of the waste management contract Private Finance Initiative (PFI) scheme, was opened on 14 July 2011 for the benefit of local residents. Up to the date of the completion and hand over of the facility, the construction costs of the facility were 'off balance sheet' and an element of the annual contract charge has been recognised as a payment in advance. However, as the asset is now in use, it will need to be formally valued and recognised in the Council's balance sheet, with a liability for the financing provided by the PFI operator, in accordance with IFRIC 12 *Service concession arrangements* and the *Code of Practice for local authority accounting*. Given the complexities involved in PFI accounting, there is a risk that the Council may not appropriately value and account for the new household waste recycling facility in accordance with the requirements of the financial reporting framework. **(2) PFI model** We understand that the waste contract team is also considering amending the PFI model that has been used to account for the waste management contract since inception. We reviewed the integrity of the model during our audit of the 2009/10 financial statements, when the Council was first required to account for its PFI schemes under International Financial Reporting Standards. There is a risk that the availability of a new model, if relevant, may result in materially different transaction outputs compared to the current model, in which case we would require detailed explanations for the differences and we would need to audit the new model.	Valuation of PFI assets and liabilities	**(1) Household waste recycling facility** We will evaluate the arrangements that the Council has put in place to value the new household waste recycling facility and we will review the Council's transactions to account for the asset and liability. **(2) PFI model** We will determine whether there is a different model in place and whether there are any differences in the transaction outputs from the models. If there are different models that result in materially different transactions, we would require detailed explanations for the differences.

Appendix B – Our responsibilities

Financial statements

The Code requires us to provide an opinion on whether your financial statements are "true and fair" and have been prepared properly, in accordance with relevant legislation and applicable accounting standards.

We will consider the adequacy of your arrangements for closing down the ledger and producing accurate, timely and comprehensive financial statements and supporting working papers. We will provide officers with a detailed list of schedules and working papers required for the audit.

We will review the appropriateness and consistency of application of the accounting policies adopted by the Council and ensure that these are consistent with the Code.

We will report to you significant aspects of the accounting practices adopted by the Council, including the application of the Code and other significant matters relevant to the financial reporting process.

We will also report uncorrected misstatements and material uncertainties relating to going concern.

We will read the other information included in the Statement of Accounts to ensure this is consistent, complete and not misleading based on our overall knowledge.

We will review your Annual Governance Statement to assess whether it has been presented in accordance with relevant guidance, is adequately supported, that an effectiveness review has been completed, and it is consistent, complete and not misleading based on our overall knowledge.

We will report to you significant matters discussed, or subject to correspondence with management or other employees; and also any significant difficulties that we encountered during the course of the audit.

We will seek written representations from the Council or from other parties to acknowledge and understand responsibilities for preparing the financial statements, for the internal controls necessary to enable preparation of the financial statements that are free from material misstatement whether due to fraud or error, and that we have been provided with access to all information of which you are aware of that is relevant to the preparation of the financial statements.

Where we propose any modifications to the audit opinion or emphasis of matter paragraphs in the auditor's report, we will report this to you along with the reasons for the modifications.

Internal controls and significant financial systems

International Standards on Auditing (UK and Ireland) require auditors to obtain a detailed understanding of an organisation, its environment, risk assessment processes, the information systems, internal controls and monitoring activities. This must be sufficient to identify and assess the risks of material misstatement of the financial statements whether due to fraud or error and be sufficiently well documented to enable the auditor to design and perform further audit procedures based on identified risks.

Where the audit intends to rely on identified controls to reduce risk or the level of detailed testing the auditor must also undertake tests of the operating effectiveness of the relevant controls. The key financial systems upon which the accounts are based will therefore require additional testing and review in order to arrive at our opinion on the financial statements.

Your significant financial systems are:

- Main accounting
- Cash and bank
- Payments and creditors
- Income and debtors
- Payroll and employment costs
- Investments and investment income
- Property, plant and equipment
- Trapeze (Passenger Transport)
- Abacus Income (Adult Social Care)
- Abacus Payments (Adult Social Care)
- Controcc (Adult Social Care)
- SPOCC (Supporting People)
- Carepay (Children's Services)
- Information Technology

We will report to management any deficiencies in internal control identified during the audit. Where we identify significant deficiencies in internal control identified during the audit we will also report those to those charged with governance.

Working with Internal Audit

In order to achieve an efficient and cost effective audit, we aim to work closely with Internal Audit and to effectively target work and minimise duplication and the overall level of audit resource input.

We have planned the audit on the basis that we will be able to place full reliance on the work of Internal Audit and that its work will be directed to each of the key financial systems noted above.

Fraud risk assessment

We have a responsibility to consider specifically the potential risk of material misstatement of your financial statements as a result of fraud and error, including the risk of fraudulent financial reporting.

The primary responsibility for ensuring that your internal control frameworks are robust enough to prevent and detect fraud and corrupt practices lies with management and "those charged with governance" (the Audit, Best Value and Community Services Scrutiny Committee) and the Governance Committee.

We will make appropriate enquiries and review the counter fraud arrangements in place in order to identify the fraud risks, and the controls you have put in place on which we will seek to place reliance to mitigate those risks.

For all fraud risks, and for any actual frauds that have been identified and we have been informed of, we will consider the possible impact on your financial statements and our audit programme.

Assessment of compliance with laws and regulations risks

We have a responsibility to consider specifically the potential risk of material misstatement of your financial statements as a result of significant financial transactions that are outside of the powers available to the Council.

The primary responsibility for compliance with relevant laws and regulations is with management and those charged with governance, which will include establishing internal controls to ensure that statutory powers are available to support all significant transactions and actions of the Council.

We will review the internal controls in place and take reasonable steps to inform ourselves of significant financial transactions that are unusual or of questionable legality.

Planned audit approach

Our audit assurance will be derived from a combination of our review of the effectiveness of internal controls (see above) and further substantive audit procedures such as analytical review and detailed tests of transactions and balances where appropriate.

Analytical procedures will focus on the relationship of transactions and balances to supporting evidence and on the reported performance for the year compared to the annual budget, including review of variances where appropriate.

Depending on the nature of the risk of misstatement of classes of transactions and balances, taking into account the strength of internal controls, we will test a sample of transactions for agreement to underlying evidence provided by third-parties and management. This will include a review of the assumptions applied in assessing the financial impact from uncertainties and estimation.

Additional audit effort and procedures will be directed to areas of greater risk such as higher value items, and items subject to a greater degree of uncertainty or estimation.

Reliance on experts and others

Where the financial statements or disclosures include amounts derived from information or estimates provided by experts, the auditor may seek to place reliance on that work in obtaining audit evidence. As part of our work we expect to obtain assurance on the work undertaken by the following management's experts:

- Hyman's Robertson, the Council's actuary, for valuation of the pensions liability and provision of pension fund disclosures
- Wilks, Head and Eve, the Council's property valuers, for valuations of land and buildings
- Sector, the Council's treasury management advisers, for valuation of financial instruments
- JLT, for valuation of the insurance fund reserve.

Whole of Government Accounts

As part of the WGA process we are required to review and report on the consolidation pack you have prepared for submission. The actual procedures to be performed have been developed by the Audit Commission in discussion with the National Audit Office. Our work involves ensuring consistency between the audited financial statements and the consolidation pack, and the agreement of balances with other bodies.

Value for money conclusion

The Code requires auditors to issue a conclusion on whether the audited body has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

This is based on the following two reporting criteria:

- the organisation has proper arrangements in place for securing financial resilience
- the organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.

The focus of the criteria for 2011/12 is:

- the organisation has robust systems and processes to manage financial risks and opportunities effectively, and to secure a stable financial position that enables it to continue to operate for the foreseeable future
- the organisation is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.

We will plan a programme of value for money audit work based upon our risk assessment.